



ACADEMY OF DOVER
(A Component Unit of the State of Delaware)
Dover, Delaware

AUDITED FINANCIAL STATEMENTS
For the Fiscal Year Ended June 30, 2006

ACADEMY OF DOVER
AUDITED FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2006

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INDEPENDENT AUDITOR'S REPORT

TO THE SCHOOL BOARD MEMBERS
ACADEMY OF DOVER
Dover, Delaware

We have audited the accompanying financial statements of the governmental activities and each major fund of Academy of Dover (the School) (a component unit of the State of Delaware) as of and for the year ended June 30, 2006 which collectively comprise the School's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the School's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and each major fund of the School as of June 30, 2006 and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the School will continue as a going concern. As discussed in Note M to the financial statements, the School has suffered recurring losses from operations and has a deficiency in net assets which raises substantial doubt about its ability to continue as a going concern. Management's plans regarding those matters are described in Note L. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 30, 2006 on our consideration of the School's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the

internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Management's Discussion and Analysis is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. The School has not presented the Management's Discussion and Analysis that the Governmental Accounting Standards Board has determined is necessary to supplement, although not required to be part of, the basic financial statements.

The budgetary comparison information on pages 18 through 19 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

R. Thomas Wagner, Jr., CFE, CGFM, CICA
Auditor of Accounts
Office of Auditor of Accounts

October 30, 2006

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN
AUDIT OF BASIC FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

TO THE SCHOOL BOARD MEMBERS
ACADEMY OF DOVER
Dover, Delaware

We have audited the financial statements of the governmental activities and each major fund of the Academy of Dover (the School) as of and for the year ended June 30, 2006, which collectively comprise the School's basic financial statements, and have issued our report thereon dated October 30, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the School's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the School's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and questioned costs as item 2006-01.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relative low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. We consider reportable condition described above, Finding 2006-01, to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the School's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as item 2006-01.

This report is intended solely for the information and use of the School's management, School Board Members, Department of Education, Office of the Governor, Office of Controller General, Office of Attorney General, Office of Management and Budget, and Department of Finance and is not intended to be and should not be used by anyone other than these specified parties. However, under 29 Del. C., Section 10002(d), this report is a public record and its distribution is not limited.

R. Thomas Wagner, Jr., CFE, CGFM, CICA
Auditor of Accounts
Office of Auditor of Accounts

October 30, 2006

ACADEMY OF DOVER

STATEMENT OF NET ASSETS
JUNE 30, 2006

	GOVERNMENTAL ACTIVITIES
<u>ASSETS</u>	
CURRENT ASSETS	
Cash and Cash Equivalents	\$ 174,579
Receivables	
Governments - Federal Through State	13,226
TOTAL CURRENT ASSETS	<u>187,805</u>
NONCURRENT ASSETS	
Capital Assets, Net of Depreciation	<u>300,904</u>
TOTAL ASSETS	<u>488,709</u>
<u>LIABILITIES</u>	
CURRENT LIABILITIES	
Accounts Payable	51,623
Accrued Salaries and Related Costs	188,183
Notes Payable	200,262
TOTAL CURRENT LIABILITIES	<u>440,068</u>
NONCURRENT LIABILITIES	
Notes Payable	<u>347,009</u>
TOTAL LIABILITIES	<u>787,077</u>
<u>NET ASSETS</u>	
Invested in Capital Assets, Net of Related Debt	300,904
Unrestricted (Deficit)	<u>(599,272)</u>
TOTAL NET ASSETS	<u>\$ (298,368)</u>

See accompanying notes to the financial statements.

ACADEMY OF DOVER

STATEMENT OF ACTIVITIES
YEAR ENDED JUNE 30, 2006

		PROGRAM REVENUES			NET (EXPENSE) REVENUE AND CHANGES IN NET ASSETS
	<u>EXPENSES</u>	<u>CHARGES FOR SERVICES</u>	<u>OPERATING GRANTS AND CONTRIBUTIONS</u>	<u>CAPITAL GRANTS AND CONTRIBUTIONS</u>	<u>TOTAL GOVERNMENTAL ACTIVITIES</u>
GOVERNMENTAL ACTIVITIES					
Instructional Services	\$ (1,753,464)	\$ -	\$ 208,675	\$ -	\$ (1,544,789)
Supporting Services:					
Operation and Maintenance of Facilities	(931,551)	-	-	-	(931,551)
Transportation	(261,628)	-	-	-	(261,628)
School Lunch Services	(127,492)	24,404	124,971	-	21,883
TOTAL CHARTER SCHOOL	<u>\$ (3,074,135)</u>	<u>\$ 24,404</u>	<u>\$ 333,646</u>	<u>\$ -</u>	<u>(2,716,084)</u>
GENERAL REVENUES					
Charges to School Districts					379,934
State Aid not Restricted to Specific Purposes					2,475,095
Earnings on Cash and Cash Equivalents					5,915
Miscellaneous Revenues					6,072
TOTAL GENERAL REVENUES					<u>2,867,016</u>
CHANGE IN NET ASSETS					150,931
NET ASSETS AT BEGINNING OF YEAR					<u>(449,299)</u>
NET ASSETS AT END OF YEAR					<u>\$ (298,368)</u>

See accompanying notes to the financial statements.

ACADEMY OF DOVER

BALANCE SHEET - GOVERNMENTAL FUNDS
JUNE 30, 2006

<u>ASSETS</u>	<u>GENERAL FUND</u>
Cash and Cash Equivalents	\$ 174,579
Receivables	
Governments - Federal Through State	<u>13,226</u>
TOTAL ASSETS	<u>187,805</u>
 <u>LIABILITIES</u>	
Accounts Payable	51,623
Accrued Salaries and Related Costs	<u>188,183</u>
TOTAL LIABILITIES	<u>239,806</u>
 <u>FUND BALANCES</u>	
Reserved for Encumbrances	3,374
Unreserved (Deficit)	<u>(55,375)</u>
TOTAL FUND BALANCES	(52,001)
TOTAL LIABILITIES AND FUND BALANCES	<u>\$ 187,805</u>

See accompanying notes to the financial statements.

ACADEMY OF DOVER

RECONCILIATION OF THE BALANCE SHEET OF
GOVERNMENTAL FUNDS TO THE STATEMENT OF NET ASSETS
JUNE 30, 2006

AMOUNTS REPORTED FOR GOVERNMENTAL ACTIVITIES IN THE
STATEMENT OF NET ASSETS ARE DIFFERENT BECAUSE:

Total Fund Balances - Governmental Funds	\$ (52,001)
Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds. The total cost of capital assets is \$506,760 and the related accumulated depreciation is \$205,856.	300,904
Long-term debt liabilities are not due and payable in the current period and, therefore, are not reported as liabilities in the funds.	<u>(547,271)</u>
TOTAL NET ASSETS - GOVERNMENTAL ACTIVITIES	\$ <u>(298,368)</u>

See accompanying notes to the financial statements.

ACADEMY OF DOVER

STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCES - GOVERNMENTAL FUNDS
YEAR ENDED JUNE 30, 2006

	<u>GENERAL FUND</u>
REVENUES	
State Support	\$ 2,475,095
Federal Support	208,675
Charges to School Districts	379,934
School Lunch Services - Grants	124,971
School Lunch Services - Charges for Services	24,404
Earnings on Cash and Cash Equivalents	5,915
Miscellaneous Revenues	6,072
TOTAL REVENUES	<u>3,225,066</u>
EXPENDITURES	
Current	
Instructional Services	1,692,890
Supporting Services:	
Operation and Maintenance of Facilities	905,360
Transportation	261,628
School Lunch Services	127,492
Capital Outlay	
Land, Buildings, and Improvements	-
Debt Service	
Principal	110,124
Interest	20,614
TOTAL EXPENDITURES	<u>3,118,108</u>
EXCESS OF REVENUES OVER EXPENDITURES	106,958
FUND BALANCES (DEFICIT) AT BEGINNING OF YEAR	<u>(158,959)</u>
FUND BALANCES (DEFICIT) AT END OF YEAR	<u>\$ (52,001)</u>

See accompanying notes to the financial statements.

ACADEMY OF DOVER

RECONCILIATION OF THE STATEMENT OF REVENUES,
EXPENDITURES, AND CHANGES IN FUND BALANCE OF
GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
YEAR ENDED JUNE 30, 2006

AMOUNTS REPORTED FOR GOVERNMENTAL ACTIVITIES IN THE
STATEMENT OF ACTIVITIES ARE DIFFERENT BECAUSE:

Net Change in Fund Balances - Total Governmental Funds	\$	106,958
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Governmental funds report capital outlays as expenditures. However, in the statement of activities, assets with an initial, individual cost of more than \$1,000 are capitalized and the cost is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which capital outlays exceeded depreciation in the current period.

Capital Outlays		8,000
Depreciation Expense		(74,150)

Governmental funds report repayments of capital lease liabilities as debt expenditures. However, in the statement of net assets, the repayment reduces long-term leases payable.		65,816
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Governmental funds report repayments of long-term debt as an expenditure, but the repayment reduces long-term liabilities in the statement of net assets.		44,307
		<hr/>

CHANGE IN NET ASSETS - GOVERNMENTAL ACTIVITIES	\$	<u>150,931</u>
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See accompanying notes to the financial statements.

ACADEMY OF DOVER

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2006

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the Academy of Dover (the School) have been prepared in conformity with accounting principles generally accepted in the United States of America as applied to local government units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The more significant accounting policies of the School are described below.

Reporting Entity

The School, which opened in September 2003, was established to provide a unique learning environment to students. The School is a component unit of the State of Delaware. A component unit, although a legally separate entity, is in substance part of the State of Delaware's operations. The School has no component units for which it is considered to be financially accountable.

Government-Wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all activities of the School.

The statement of activities demonstrates the degree to which the direct expenses of a given program are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific program. Program revenues include 1) charges to students who purchase, use, or directly benefit from goods and services provided and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. Grants and other revenues not properly included among program revenues are reported as general revenues.

Measurement Focus, Basis of Accounting and Financial Statement Presentation

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Charges to school districts are recognized as revenues in the year for which they are billed. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the School considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures and capital leases are recorded only when payment is due.

The School reports only one fund which is the general fund (a governmental fund type).

Cash And Cash Equivalents

Except for the petty cash and cafeteria accounts, cash and cash equivalents of the School are controlled by the State Treasurer's Office in Dover, Delaware. The petty cash and cafeteria accounts are controlled by the School.

ACADEMY OF DOVER

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

Receivables

All receivables are considered fully collectible by management. No allowance for bad debts is deemed necessary.

Capital Assets

Capital assets, which include furniture and equipment, are reported in the government-wide financial statements. The School defines capital assets as assets with an initial individual cost of more than \$1,000 and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets would be recorded at estimated fair value at the date of donation.

The cost of normal repairs and maintenance that do not add to the value of the asset or materially extend lives of the assets are not capitalized.

Furniture and equipment of the School are depreciated using the straight-line method over the estimated lives of the assets, which range from five to twenty years.

Compensated Absences

Vacation

Employees are not paid for unused vacation upon resignation or termination. Twelve-month salaried employees are entitled to 12 days of vacation each year.

Sick and Personal Leave

Employees are not paid for unused sick or personal leave upon resignation or termination. Sick leave allowances are as follows: 10 days for 10-month salaried employees and 12 days for 12-month salaried employees. Two sick days can be taken as personal days for both 10-month and 12-month salaried employees.

Fund Balance

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a restricted purpose.

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

ACADEMY OF DOVER

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006

NOTE B - CASH AND CASH EQUIVALENTS

At June 30, 2006, the School has cash and cash equivalents balance of \$174,579. Of that amount, \$149,418 is part of an investment pool controlled by the personnel of the State Treasurer's Office in Dover, Delaware and all investment decisions are made by the State Treasurer's Office. These funds are considered to be highly liquid and available for immediate use and, thus, are recorded as cash equivalents in these financial statements.

The funds held by the State of Delaware investment pool, an internal investment pool, are specifically identified for the School, but the credit risk cannot be categorized for these funds. Credit risk for such investments depends on the financial stability of the State. The State reports that its investment securities are stated at quoted market prices, except that investment securities with a remaining maturity at time of purchase of one year or less are stated at cost or amortized cost.

The petty cash and cafeteria petty cash accounts are in the custody of School officials. The book and bank balances of these funds were \$25,161 and \$25,435, respectively. The bank balance of cash deposits are insured by the Federal Deposit Insurance Corporation (FDIC) and, therefore, there is no custodial credit risk for these cash deposits.

NOTE C - RECEIVABLES

Receivables as of June 30, 2006, in the amount of \$13,226, represent payments due for federal lunch reimbursement.

Amounts due from local school districts totaling \$15,425 for Fiscal Year 2005 were written-off due to lack of collection efforts by the School. Amounts due from local school districts totaling \$8,496 for Fiscal Year 2006 respectively were not recorded in revenues or receivables due to lack of collection efforts by the School.

NOTE D - CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2006 follows:

	<u>BEGINNING BALANCES</u>	<u>INCREASES</u>	<u>DECREASES</u>	<u>ENDING BALANCES</u>
Capital Assets Being Depreciated:				
Furniture and Equipment	\$ 498,760	\$ 8,000	\$ -	\$ 506,760
Less Accumulated Depreciation:				
Furniture and Equipment	<u>131,706</u>	<u>74,150</u>	<u>-</u>	<u>205,856</u>
Total Capital Assets Being Depreciated, Net	<u>\$ 367,054</u>	<u>\$ (66,150)</u>	<u>\$ -</u>	<u>\$ 300,904</u>

For the year ended June 30, 2006, depreciation expenses of \$60,574 and \$13,576 were included in instructional services, and operation and maintenance of facilities, respectively.

ACADEMY OF DOVER

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006

NOTE E - LEASING ARRANGEMENTS

OPERATING LEASES

The School leases its facilities under an operating leasing arrangement expiring August 31, 2013. The facility lease started September 1, 2003. The base year rental is \$410,000. Rent is to increase by 5 percent each year for the next five years. The lease contains a five year renewal option.

The School leases cafeteria equipment under an operating leasing arrangement expiring in July 2007. The equipment lease started in October 2005. The base year rental is \$605 per month.

Rent expense for the year ended June 30, 2006 was \$417,258, of which \$410,000 was included in operation and maintenance of facilities and \$7,258 was included in school lunch services.

The future minimum lease obligations are as follows:

<u>YEAR ENDING JUNE 30,</u>	<u>AMOUNT</u>
2007	\$420,855
2008	430,756
2009	441,525
2010	452,563
2011 - 2013	1,391,631
TOTAL	<u>\$ 3,137,330</u>

CAPITAL LEASES

The School leased \$299,562 of computers and office equipment under capital leases with HP Financial Services, which ended November 1, 2005. Monthly payments including principal and interest are approximately \$14,000. Interest expense for the year ended June 30, 2006 was \$13,256 and was included in operation and maintenance of facilities.

Capital lease activity for the year ended June 30, 2006 was as follows:

	<u>BEGINNING BALANCE</u>	<u>ADDITIONS</u>	<u>REDUCTIONS</u>	<u>ENDING BALANCE</u>	<u>DUE WITHIN ONE YEAR</u>
Capital Lease	<u>\$ 65,816</u>	<u>\$ -</u>	<u>\$ (65,816)</u>	<u>\$ -</u>	<u>\$ -</u>

NOTE F - NOTES PAYABLE

On November 10, 2004, the School signed a \$129,625 note with School Specialty, Inc. bearing an interest rate of 12 percent. The terms of the note require the following payments: \$29,533 in October 2004, \$4,910 in November 2004, and \$4,305 each month thereafter with final payment due March 1, 2007. Interest expense for the year ended June 30, 2006 was \$7,358 and was included in instructional services.

The School signed three notes in Fiscal Year 2005 with its management company, Mosaica Education, Inc. The first note, representing management fees of \$156,856 for Fiscal Year 2004, bears interest at the rate of 6 percent. Monthly payments of \$4,772 were scheduled to begin July 1, 2006 with final payment due

ACADEMY OF DOVER

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006

NOTE F - NOTES PAYABLE - CONTINUED

May 1, 2009. The second note, representing management fees of \$185,067 for Fiscal Year 2005, bears interest at the rate of 6 percent. Monthly payments of \$5,630 were scheduled to begin July 1, 2006 with final payment due May 1, 2009. The third note, representing repayment of amounts loaned to the School and a buyback of supplies of \$168,468, is a non-interest bearing note. Monthly payments of \$4,680 were scheduled to begin July 1, 2006 with final payment due May 1, 2009.

Annual debt service requirements to maturity for the notes are as follows:

YEAR ENDING JUNE 30,	PRINCIPAL	INTEREST	TOTAL
2007	\$ 200,262	19,466	219,728
2008	169,994	10,985	180,979
2009	177,015	3,963	180,978
	<u>\$ 547,271</u>	<u>\$ 34,414</u>	<u>\$ 581,685</u>

Notes payable activity for the year ended June 30, 2006 was as follows:

	BEGINNING BALANCE	ADDITIONS	REDUCTIONS	ENDING BALANCE	DUE WITHIN ONE YEAR
Notes Payable	<u>\$ 591,578</u>	<u>\$ -</u>	<u>\$ 44,307</u>	<u>\$ 547,271</u>	<u>\$ 200,262</u>

NOTE G - PENSION PLAN

School employees are considered State employees and are covered under the State's pension program. The State contributed 15.02 percent for Fiscal 2006 of the State's share of the employees' salary. The School contributed the same percentages on the local share of the salary. The employees contribute 3 percent of salary in excess of \$6,000 per share up to social security maximum and 3 percent for any salary above social security maximum. Total pension cost of \$119,123 (State share), \$19,218 (federal share), and \$16,255 (local share) is included in the financial statements. Pension costs accrued at June 30, 2006 were approximately \$28,000. Certain significant plan provisions follow:

- Early Retirement:
 - a. 15 Years Service - Age 55
 - b. 25 Years Service - Any Age
- Service Retirement:
 - a. 15 Years Service - Age 60
 - b. 30 Years Service - Any Age
 - c. 5 Years Service - Age 62
- Disability Retirement:
 - a. 5 Years Service and Proof of Disability
- Vested Pension:
 - a. An employee can vest pension rights after five years of service.

The State's pension program is a defined benefit plan. More information on this plan is available in the State of Delaware Public Employee Retirement System (DPERS) Comprehensive Annual Financial

ACADEMY OF DOVER

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006

NOTE G - PENSION PLAN - CONTINUED

Report. This report may be obtained by writing DPERS at Suite 1, McArdle Building, 860 Silver Lake Boulevard, Dover, Delaware 19904, or calling 1-800-722-7300, or visiting their website at www.delawarepensions.com/information/financials.shtml.

NOTE H - COMMITMENTS AND CONTIGENCIES

In the normal course of business, there are outstanding various commitments and contingent liabilities in addition to the normal encumbrances for the purchase of goods and services. Refer to Notes K and L for detail.

Grants

The School receives financial assistance from federal agencies in the form of grants. The disbursement of funds received under these programs generally requires compliance with terms and conditions specified in the grant agreements and are subject to audit. Any disallowed claims resulting from such audits could become a liability of the School. The School's administration believes such disallowance, if any, would be immaterial.

NOTE I - RISK MANAGEMENT

The School has purchased commercial insurance policies for various risks of loss related to torts; theft, damage, or destruction of assets; errors or omissions; injuries to employees; or acts of God. Payments of premiums for these policies are recorded as expenses of the School. Insurance settlements have not exceeded insurance coverage in either of the past two years. There were no significant reductions in coverage compared to the prior year.

NOTE J - DEFICIT FUND BALANCE

The governmental activities had a deficit fund balance of \$52,001 at June 30, 2006. Due to continued decreasing enrollment, the School does not have a plan to recover the deficit fund balance.

NOTE K - GOING CONCERN

During the course of the audit, the following issues were noted: the School continues to have unrestricted net asset deficit balances; the School's student enrollment continues to decrease; the School's current ratio continues to be less than .5; and, during Fiscal Year 2006, the School lost revenues due to bookkeeping errors. These issues create an uncertainty about the School's ability to continue as a going concern. Refer to Note J for management's plans to increase revenues.

NOTE L - RELATED PARTY TRANSACTIONS

On June 19, 2006, the School terminated its contract with Mosaica Education, Inc. (MEI). MEI has asserted a claim before the American Arbitration Association against the School for \$2.7 million. The amount represents future management fees, reimbursement for payments made by MEI, payment of past fees that have been reduced to promissory notes, and other miscellaneous amounts. Although the outcome of this claim is not presently determinable, the School intends to defend the claim and assert counterclaims seeking damages for MEI's breach of the agreement. As of June 30, 2006, \$510,390 is recorded as debt owed to MEI, of which \$163,381 is due in Fiscal Year 2007. The School has decided to withhold payments on these loans until the arbitration is resolved.

REQUIRED SUPPLEMENTAL INFORMATION

ACADEMY OF DOVER

SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCE - BUDGET AND ACTUAL - GENERAL FUND
YEAR ENDED JUNE 30, 2006

	<u>BUDGETED AMOUNTS</u>		<u>ACTUAL AMOUNTS BUDGETARY BASIS</u>	<u>VARIANCE WITH FINAL BUDGET POSITIVE (NEGATIVE)</u>
	<u>ORIGINAL</u>	<u>FINAL</u>		
REVENUES				
State Support	\$ 2,442,157	\$ 2,442,157	\$ 2,475,095	\$ 32,938
Federal Support	324,357	324,357	259,339	(65,018)
Charges to School Districts	402,385	402,385	395,359	(7,026)
School Lunch Services	150,000	150,000	159,445	9,445
Miscellaneous Revenues	-	-	6,072	6,072
Earnings on Cash and Cash Equivalents	69,513	69,513	5,915	(63,598)
TOTAL REVENUES	<u>3,388,412</u>	<u>3,388,412</u>	<u>3,301,225</u>	<u>(87,187)</u>
EXPENDITURES				
Current:				
Advertising	7,500	7,500	11,288	(3,788)
Communications	25,000	25,000	26,118	(1,118)
Contracted Services	567,389	567,389	467,960	99,429
Employment Costs	538,749	538,749	465,165	73,584
Insurance	20,000	20,000	20,705	(705)
Interest	-	-	7,953	(7,953)
Land/Building/Facilities	410,000	410,000	443,917	(33,917)
Miscellaneous	143,717	143,717	11,998	131,719
Public Utility Services	67,500	67,500	48,032	19,468
Repairs and Maintenance	20,000	20,000	60,493	(40,493)
Salaries	1,136,144	1,136,144	1,165,886	(29,742)
School Lunch Services	130,405	130,405	127,249	3,156
Supplies and Materials	64,000	64,000	90,848	(26,848)
Transportation – Buses	237,000	237,000	238,070	(1,070)
Travel	1,500	1,500	789	711
Capital Outlay	19,508	19,508	13,596	5,912
TOTAL EXPENDITURES	<u>3,388,412</u>	<u>3,388,412</u>	<u>3,200,067</u>	<u>188,345</u>
EXCESS OF REVENUES OVER EXPENDITURES	<u>\$ -</u>	<u>\$ -</u>	101,158	<u>\$ 101,158</u>
Fund Balance at Beginning of Year			<u>73,421</u>	
Fund Balance at End of Year			<u>\$ 174,579</u>	

ACADEMY OF DOVER

NOTES TO THE SCHEDULE OF REVENUES, EXPENDITURES, AND
CHANGES IN FUND BALANCE -
BUDGET AND ACTUAL - GENERAL FUND
YEAR ENDED JUNE 30, 2006

The School's budget is prepared on the cash basis of accounting. The amount reported as "net change in fund balance" on the budgetary basis derives from the cash basis of accounting. Revenues are reported when received and expenditures are reported when paid. This amount differs from the "net change in fund balance" reported in the Statement of Revenues, Expenditures, and Changes in Fund Balance - Governmental Fund on page 10.

That statement is prepared on the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the School considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting.

The following reconciles the net change in fund balance per the budgetary basis to the net change in fund balance per the modified accrual basis.

NET CHANGE IN FUND BALANCE, BUDGETARY BASIS	\$ 101,158
Net Decrease in Receivables	(76,653)
Net Decrease in Prepaid Items	(1,288)
Net Decrease in Payables	47,331
Net Decrease in Accrued Salaries and Related Costs	<u>36,410</u>
NET CHANGE IN FUND BALANCE, MODIFIED ACCRUAL BASIS	<u>\$ 106,958</u>

OTHER INFORMATION

ACADEMY OF DOVER

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2006

SUMMARY OF AUDITOR'S RESULTS

1. The auditor's report expresses an unqualified opinion on the basic financial statements of Academy of Dover.
2. A reportable condition was identified during the audit of the basic financial statements of Academy of Dover.
3. An instance of noncompliance material to the financial statements of Academy of Dover was disclosed during the audit.

FINDINGS - COMPLIANCE AND FINANCIAL REPORTING

FINDING 2006-01

Academy of Dover Charter School's internal control is insufficient to meet the achievement of objectives in the following categories: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations.

The School's lack of knowledge of internal control and generally accepted accounting principles (GAAP) has resulted in lost revenue, improper and inconsistent financial reporting, and lack of support for financial transactions.

The State of Delaware *Budget and Accounting Manual* states that department or agency heads are responsible for establishing and maintaining an effective system of internal control. The Committee of Sponsoring Organizations of the Treadway Commission report entitled *Internal Control – Integrated Framework* (COSO) defines internal control as, “a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations.” COSO further states there are five interrelated components of internal control:

- Control environment - The organization structure and culture created by management and employees to sustain organizational support of internal control.
- Risk assessment - An entity must be aware of and deal with the risks it faces. The entity must set objectives, integrated with financial and other activities, so that the organization is operating in concert. It also must establish mechanisms to identify, analyze, and manage the related risks.
- Control activities - Control policies and procedures must be established and executed to help ensure that the actions identified by management as necessary to address risks to achievement of the entity's objectives are effectively carried out. Operating policies and procedures should be clearly written and communicated. Documentation of policies and procedures provides (1) an understanding of the entity's objectives, (2) a basis for training new personnel, (3) a means of communicating common information, (4) a source of information about accounting controls, and (5) a source of information that will aid in providing continuity in the event experienced personnel leave.

ACADEMY OF DOVER

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2006

- Information and communication - Information and communication systems enable the entity's people to capture and exchange information needed to conduct, manage, and control its operations.
- Monitoring - The entire process must be monitored, and modifications made as necessary. In this way, the system can react dynamically, changing as conditions warrant.

Details of the School's internal control deficiencies are as follows:

Salaries and Other Employment Costs

The School understated accrued payroll as of June 30, 2006 by approximately \$83,000. The accrued payroll did not include all relevant pay periods or employees. Lack of knowledge of GAAP resulted in the understatement of liabilities. The School subsequently corrected payroll upon recommendation by the Office of Auditor of Accounts (AOA).

A key objective of the payroll cycle is that amounts due to, or on behalf of, employees, and the accounting distribution of those amounts, should be accurately computed and properly classified, summarized, and reported in financial records. Control activities to meet this objective include (a) reconciliation of amounts to supporting detail and registers and (b) management review of payroll reports and distribution.

Expenditures and Accounts Payable

The School understated accounts payable as of June 30, 2006 by \$17,332; six invoices were improperly excluded from the accounts payable listing. The School subsequently corrected accounts payable upon recommendation by AOA.

The School inconsistently coded expenditures within and between years. Inconsistent coding has led to difficulty in preparing budgets, comparing financial information, and identifying discrepancies and/or fraudulent activity.

The School could not provide support for eight of nine expenditure transactions charged against federal awards. Due to the lack of documentation, AOA could not determine the allowability or propriety of \$68,589 of expenditures charged to federal awards.

Four key objectives of the procurement cycle are:

- Amounts due to vendors for goods and services accepted, and the accounting distributions of such amounts, should be computed and promptly recognized as liabilities.
- Amounts due to vendors should be accurately and promptly classified, summarized, and included in any related financial records.
- Liabilities incurred, and related adjustments, should be accurately applied to the proper vendors' accounts.
- Recorded balances of accounts payable, and related transaction activity, should be periodically substantiated and evaluated.

ACADEMY OF DOVER

SCHEDULE OF FINDINGS AND QUESTIONED COSTS YEAR ENDED JUNE 30, 2006

Control activities to meet these objectives include:

- Use of receiving logs or receiving report numbers to ascertain that each receipt is recognized as a liability within the appropriate period of time.
- Documented processing, cutoff, and period-end closing procedures.
- Reconciliation of the vendors' statements with the accounts payable subsidiary ledger.
- Techniques used to detect errors and omissions.
- Techniques used to provide reasonable assurance that recorded balances are evaluated.

Inventory

The School does not maintain a master inventory listing. Although teachers completed inventory forms at the end of the 2005-2006 School Year, the accuracy of the inventory cannot be determined. The lack of an adequate inventory system impedes the School's ability to safeguard the State's assets against theft and misappropriation.

Some key objectives of the asset management cycle are:

- Assets acquired should be accurately and promptly recorded in financial records.
- Assets are afforded adequate physical security.
- Recorded assets should be periodically substantiated and evaluated.

Control activities to meet these objectives include:

- Periodic physical inventory.
- Periodic internal audits.
- Use of identifying tags or inscribing identifying data on equipment, where appropriate.

Revenues and Receivables

State Support

The majority of the School's funding is received from the State; yet, the School does not have procedures to determine the accuracy of State revenues received from the Department of Education. The School could not locate the request for transfer (TA) documents in which State funds are transferred to the School.

Many State appropriations must be used by the School within one year; otherwise, the funds revert back to the State. The School lost \$28,377 of State funds when the funds were not used within the period of availability.

The Department of Education funds charter schools based on actual statistics, such as teachers' years of experience and education. Per testing of a sample of six employees, the School understated one teacher's years of experience, resulting in a loss of funds.

Federal Support

The School received \$12,085 of Impact Aid funds during August 2005 and subsequently coded the revenues to the incorrect appropriations. The appropriations to which the funds were coded expired in September 2005; therefore, the School was unable to spend the funds. The School did not have any controls in place to timely identify and correct this error, resulting in lost revenues.

ACADEMY OF DOVER

SCHEDULE OF FINDINGS AND QUESTIONED COSTS YEAR ENDED JUNE 30, 2006

Charges to School Districts

The School's lack of controls over billings to local school districts has resulted in the loss of approximately \$23,921 in local revenues; \$15,425 and \$8,496 represent amounts due from the 2005 and 2006 School Years, respectively. The School did not take appropriate follow-up action to collect these funds, resulting in loss of revenue.

School Lunch Services

Upon submission of required monthly reports, the School receives monthly Federal reimbursements for the costs of providing students free and reduced breakfasts and lunches. Due to cafeteria management turnover, the School did not submit data for the June 2006 reimbursement. This resulted in lost revenue of approximately \$8,000.

The School receives funds daily from students for sales of breakfasts and lunches. No deposits for cafeteria sales were made for the months of August or October 2005. Due to insufficient documentation maintained by the School, AOA could not determine actual sales during the two months. School officials indicated the funds were held in a filing cabinet until the following months when deposits were made. However, AOA did not see large deposits in subsequent months, indicating possible misappropriation of assets.

School Lunch Services and Miscellaneous Revenues

The School improperly records revenue detail of the petty cash and cafeteria accounts. The School recorded cash receipts for these accounts as reductions of expenditures, instead of proper revenue classifications such as donations, grants, and student activities.

Summary

Control deficiencies resulted in the loss of over \$72,000 in state, local, and federal funding during Fiscal Year 2006.

Some control objectives of the revenue/receivable cycle including financial reporting of revenues/receivable are as follows:

- Recorded balances of receipts and accounts receivable, and related transaction activity, should be periodically substantiated and evaluated.
- Receipts, collection on accounts, and related adjustments should be accurately applied to the proper receivable accounts.
- Receipts and adjustments to receipts should be accurately and promptly classified, summarized, and reported.
- Collection attempts should be timely and documented.
- Reporting entries should classify activities in accordance with management's plan.
- Reports should be prepared accurately and promptly, be prepared on a consistent basis and fairly present the information they purport to display.

Control activities to meet these objectives include:

- Reconciling subsidiary accounts receivable to general ledger balances or other control totals on a regularly scheduled basis.

ACADEMY OF DOVER

SCHEDULE OF FINDINGS AND QUESTIONED COSTS YEAR ENDED JUNE 30, 2006

- Reconciliation of recorded balances and activities with balances and activities reported by other entities.
- Written closing procedures stating, by function, the sources to be used to prepare journal entries, cutoffs to be observed, accruals to be made, and who is responsible for each activity.
- Reconciliation of the prior period's data and current period's activities to the current period's data.
- Periodic verification of activity reports with underlying documentation.

Other

A sample of financial transactions was selected for review. The School could not locate the following documents; hence AOA could not determine the propriety of the transactions.

- a. 1 out of 10 CRs, valued at \$8,528
- b. 3 out of 15 petty cash transactions, valued at \$3,735
- c. 1 out of 5 CAs, valued at \$2,825
- d. 1 out of 4 JVs, valued at \$5,662
- e. 1 out of 10 student free and reduced lunch applications

Summary

Control deficiencies resulted in:

- Understatement of June 30, 2006 accrued payroll by approximately \$83,000;
- Understatement of June 30, 2006 accounts payable by \$17,332;
- Inconsistent coding of expenditures within and between years;
- Loss of over \$72,000 in state, local, and federal funding during Fiscal Year 2006; and
- Lack of support for several transactions totaling \$89,339.

RECOMMENDATION

Academy of Dover obtain training for the Board, management, and others tasked with financial responsibility. The training should include the State's financial system, State rules and regulations, internal controls, and generally accepted accounting principles.

The School implement a sufficient internal control structure, incorporating the five components identified by COSO.

AUDITEE RESPONSE

The Board of Directors and the Academy of Dover's management team agrees with many of the recommendations set forth in the findings. The Academy of Dover was managed by Mosaica Education, Inc. from inception of the school through fiscal year 2006. Mosaica mislead [sic] the Board of Directors and the management team as it relates to the school's financial position. Previous audits and meetings with the Department of Education personnel confirmed that problems existed but Mosaica assured the Board of Directors that practices would be put into place to ensure the school's financial viability. As it became clear that problems were not being addressed, the Board of Directors terminated their contract with Mosaica effective June 2006. On June 27, 2006 the Board of Directors engaged Innovative School Development Corporation (ISDC) to help management team prepare for the 2006-2007 school year. ISDC is not a management company.

ACADEMY OF DOVER

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2006

The contract with ISDC is to provide assistance with DFMS and PHRST input and financial reporting. No original school documents, financial or otherwise, will be maintained by ISDC. The Board of Directors understands that it faces challenges in implementing these practices due to limited personnel and will rely on Board members and staff to wear multiple hats in order to operate and provide effective controls. Board members Raymond Book and Leon Battle will be responsible for substantiating and evaluating state and local income and expenditures. Board members, Mary Scott and Juanita Cooper will be responsible for substantiating and evaluating income and expenses for state and federal grants. The Board of Directors and the management team will assure effectiveness and efficiency of operations, reliable financial reporting, and compliance with all applicable laws and regulations. The Board of Directors realize [sic] that in order to meet the school's financial obligations it must ensure a viable enrollment. Two plans are being implemented to achieve that goal, one plan for recruiting new students and another for retaining existing students. In our charter renewal the Board is seeking to change the Academy of Dover's grade configuration from K - 6 to K - 4. This better conforms to other schools in our area, increases our income per student and best conforms to our past success in the classroom. The Board of Directors are [sic] confident that these changes along with the removal of Mosaica as a management company will allow the school to be successful in offering a choice for parents in meeting the educational needs of students in the Dover area.

Accrued Payroll and Accounts Payable Findings:

A misunderstanding of the responsibilities between the school and ISDC led to A/P and A/R being understated. We believe that this understatement of the school's financial position is a reporting deficiency, not a control weakness. The school works off of DFMS which is a cash basis system and the school's cash was accurate as of June 30, 2006. If the above misunderstanding had not occurred, the findings are part of the reason Mosaica's contract was terminated and have been turned over to our attorney for use in our action against Mosaica. As mentioned in the opening statement, the Board of Directors will monitor and assure that all control activities will be used to meet desired objectives.

Inventory:

Control activities have been implemented to meet this need. All school computers and monitors have been documented and any asset acquired will be promptly recorded in financial records and appropriately tagged if necessary.

Revenues and Receivables:

Impact Air funds are currently in the process of being recovered. A new cafeteria manager has been hired and has implemented all recommended control activities. Many of the other items noted in the findings are part of the reason Mosaica's contract was terminated and have been turned over to our attorney for use in our action against Mosaica. As mentioned in the opening statement, the Board of Directors will monitor and assure that all control activities will be used to meet desired objectives.

Other

This will be corrected by not having any documents leave the school, managements monitoring of the new cafeteria manager, and the Board of Directors actively assuming their responsibility of internal control.

ACADEMY OF DOVER

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2006

AUDITOR COMMENT

It is the responsibility of the School's management, which includes both the Chief Administrative Officer and Board of Directors, to create a control environment that allows for effective and efficient operations, reliable financial reporting, and compliance with applicable laws and regulations. Management should be involved in the day-to-day operation of the School, which includes establishing internal controls that restrict access to assets and that record, process, summarize, and report the School's transactions consistent with management's assertions in the financial statements. Management is ultimately responsible for the financial statements.

Regardless of whether there was a misunderstanding between ISDC and the School regarding the year-end accruals, the information provided to the auditor is the responsibility of the School's management. It is the responsibility of the School's management to understand these accruals and their preparation.

If the School tasks a designee with a function of financial reporting, the responsibility remains with the School's management to understand and provide oversight of the tasks and functions.

ACADEMY OF DOVER

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2006

STATUS OF PRIOR AUDIT FINDINGS

Finding	Recommendation	Auditee Response	Current Year Status*
Academy of Dover (AOD) has insufficient procedures regarding the expenditure process and does not have any policies and procedures regarding cash, revenues, debt, payroll and related liabilities, and input transactions.	AOD develop and implement sufficient policies and procedures regarding these components.	A tailored Accounting Manual will be available for use on or before November 30, 2005 that addresses these concerns.	Implemented.
AOD does not retain copies of DFMS reconciliation reports. In addition, the same person who inputs data into DFMS also reconciles the documents and reports.	AOD retain copies of the DFMS reconciliation reports, with preparer signature and date of preparation. School officials should review the reconciliations and sign as evidence of review and approval.	DFMS reconciliation reports will be reviewed, approved, and retained on an ongoing basis with appropriate segregation of duties factored in.	Not Implemented. AOD could not locate monthly DFMS reconciliations prepared by their management company.

Status Key:

- **Implemented:** The concern has been addressed by implementing the original or an alternate corrective action.
- **Not Implemented:** The corrective action has not been initiated.